

Internal Revenue Service  
**memorandum**

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date: AUG 16 1988

to: District Counsel, Atlanta SE:ATL  
Att'n: Lourdes M. DeSantis

from: Director, Tax Litigation Division

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subject: Technical Advice: [REDACTED] Deductibility of  
Nonqualified Deferred Compensation

Your memorandum in response to the District Director's request for legal advice with respect to the above-matter was forwarded to us for pre-issuance review.

ISSUE

Whether the taxpayer's payment of deferred bonuses and medical insurances premiums for retirees in its taxable year ending [REDACTED] is deductible in that year.

CONCLUSION

We agree with the basic conclusions reached in your memorandum. However, because the deductibility of retiree insurance premiums is now governed by IRC § 404(b)(2), we recommend that the pertinent discussion be revised to reflect its applicability.

FACTS

The payments at issue were apparently made pursuant to unfunded nonqualified plans. The payments claimed as deductions in the [REDACTED] taxable year of the taxpayer were as follows: (1) compensation earned during the [REDACTED] fiscal year; (2) bonuses earned by retired employees during employment; and (3) medical insurance premiums for retirees. In addition, we assume that the 2 1/2 month deferral rule contained in Treas. Reg. § 1.404(a)-1(T) (Q&A-2(b)(1)) has been satisfied with respect to (2) and (3) above.

The issues presented here will have an impact beyond the particular taxpayer, as there are several other examinations being conducted by the Large Case group of the Atlanta District which involve the same or similar issues.

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DISCUSSION

We agree with your analysis with respect to the deductibility of the deferred bonus payments both to current employees and retirees. We also agree with the ultimate conclusion reached with respect to the deduction of retiree medical insurance premiums. However, given that the subject memorandum will be used as guidance in other examinations, the analysis with respect to the payments for retiree health insurance should be revised to reflect the applicability of § 404(b)(2).

Section 404(b)(2)(A), which was enacted into law as part of 1984 Tax Reform Act (P.L. 98-369), provides that "any plan providing for deferred benefits (other than compensation) for employees ... shall be treated as a plan deferring the receipt of compensation ..." for purposes of § 404. The applicable regulations make clear that by virtue of this provision, all unfunded "benefit plans, however denominated, which defer the receipt of any ... benefit ..." are subject to § 404(a). Treas. Reg. § 1.404(a)-1(T), Q&A-1. Moreover, the regulations instruct that benefits will be considered as deferred

if, assuming the benefits were cash compensation, such benefits would be considered deferred compensation. Thus, a plan ... shall be presumed to be one providing for deferred benefits to the extent benefits for services are received by an employee after the 2 1/2 month period following the end of the employer's taxable year in which the related services are rendered.

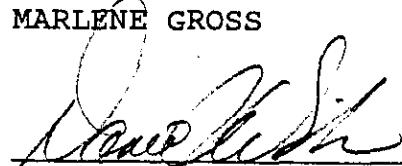
Id., Q&A-2(b)(1). It is apparent, therefore, that to the extent the 2 1/2 month rule is satisfied, the payments for retiree health benefits at issue here are plainly subject to the rules of § 404(a)(5).

In addition, § 404(b)(2)(A) also answers the concern you expressed with respect to deductibility under § 404(a)(5) where the payments, such as the premiums here, are excludable from the retirees' income. See Memorandum, at 3. Thus, it expressly provides that for purposes of § 404, "the determination of when an amount is includible in gross income shall be made without regard to any provisions of this chapter excluding such benefits from gross income." Accordingly, the retiree premium payments at issue are, as you concluded, deductible (if at all) in the taxable year of the taxpayer within or with which ends the retirees' taxable year in which such premium payments would be includible but for the application of IRC § 106. See generally Treas. Reg. § 1.404(a)-12(b)(1) & (2).

If you need any further assistance in this matter, please contact David Mustone of this Division at FTS 566-3407. We are returning your memorandum herewith. Please send us a copy of your revised memorandum for our records.

MARLENE GROSS

By:

  
DANIEL J. WILES  
Chief, Branch No. 3  
Tax Litigation Division

Attachment:  
As stated.